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The multilateral trading

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This policy contribution was prepared for the French Conseil d'analyse économique. e authors are grateful to Jean Beuve, Amélie Schurich-Rey, Samuel Delpeuch and Louis Vedel of CAE, and to Vincent Vicard (CEPII), Sandrine Gaudin, Muriel Lacoue-Labarthe and Édouard Bourcieu, as well as their colleagues, for the interviews and information provided.

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attributable to trade liberalisation, though it should not be an obstacle to European support for labour-market areas severely hit by unemployment. In addition, while trade globalisation requires resources, fiscal resources especially, to redistribute its benefits and effectively support the most vulnerable sections of society, financial globalisation, through the mobility of capital, of production and of the taxable base – in particular that of large corporate groups – makes this redistribution more difficult. In practice, along with competition and tax optimisation (or even tax evasion) it puts unprecedented pressure on our redistribution systems. Trade integration also acts as an incentive to tax competition as it facilitates the relocation of production in response to tax advantages. For this reason, the political sustainability of globalisation calls for trade liberalisation issues to be linked with tax competition issues. This sustainability is now being challenged in most advanced countries, which are confronted with movements of opinion in favour of greater protection. However, Guiso *et al.* (2018) show that exposure to globalisation (as measured by the intensity of increased competition from Chinese imports) is not the only explanation for the rise in populism. In the countries mostly hit by the financial crises in the euro area (2008-13), economic insecurity and the perceived inability of governments to protect them effectively against such crises have added to globalisation as factors explaining the rise in populism (Guiso *et al.*, 2018). There is also a parallel with the situation in the 1930s as recent work by economic historians shows that it was in countries that were unable (because of the gold standard) or unwilling to use monetary instruments to stimulate their economies that protectionist temptations were the strongest.

Finding 2. The rise of populism is not only or even primarily fuelled by trade openness but rather by the sense of economic insecurity and growing inequalities.

A repeated aim of the Trump administration is to reduce bilateral trade deficits (in particular with China and Germany). This focus on bilateral deficits and surpluses rather than aggregate trade deficits and surpluses is flawed. Bilateral imbalances are largely linked to the respective industrial structures or value chain mechanisms[4]. Since a country's trade balance is not determined by its trade policy but rather reflects its net savings, increasing trade protection has no impact on this balance, as the real exchange rate is adjusted, either by the nominal exchange rate or by inflation, if the savings imbalance persists. At the bilateral level, the argument is even more incongruous, given the poor economic sense of the bilateral balance in a context where supply chains are widely internationalised. However, the aggregate trade deficits and surpluses of large countries are a relevant issue since the global imbalances they generate might partly explain the 2008-09 crisis. But these imbalances have little to do with trade policies (tariffs and trade agreements). There is no empirical correlation between trade balance and customs duties[5]. The current account is impacted by macroeconomic factors, such as fiscal policy, exchange rates, asset prices and productivity. In order to prevent the protectionist and populist contagion, governments should thus not hesitate to use macroeconomic instruments to support the economy in the event of a crisis. While the macroeconomic response worked relatively well in 2009 at the G20 level, it was then defective, in particular in the euro area. We conclude from this that the debate on current imbalances should be shifted from bilateral trade issues to multilateral macroeconomic issues. While discussions on this subject can take place within the framework of the G7 or G20, the three main players are undoubtedly the USA, the EU (and in particular the euro area) and China (G3).

4 For example, Germany has an aggregate trade surplus (of €244.9 billion in 2017) and has bilateral deficits with a number of eastern European countries from which it imports intermediate goods. Gross bilateral deficits do not take into account the fact that the value of exported goods (eg from China to the US) represents not only the value added by Chinese companies but also the value of intermediate goods imported by China. This difference between gross bilateral deficit and added value is about 40 percent in the case of the United States/China.

5 There is no robust international relationship between the level of trade protection and trade balance. See, for example, Gagnon (2017) or Hufbauer and Zhiyao (2016).

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ree decisions by the Trump administration constitute attacks on multilateral rules. e rst, since 2017, concerned the blocking strategy on the appointment of new judges to the WTO Appellate Body, which could jeopardise the dispute resolution system. e Appellate Body, considered the 'crown jewel' of the WTO, is essential for the proper functioning of the international trading system, which relies on its ability to enforce the rules accepted by its members. e second decision (March 2018) was to invoke the national security argument to apply additional customs duties of 25 percent on steel imports and 10 percent on aluminium imports – which were implemented for the European Union on 1 June 2018 – amounting to $6.4 billion in total. In this context, the EU rightly believes that it is entitled to respond to unilateral US measures a ecting the European Union, Canada and Japan. e fact that the, sii00tQ32 0 l71/Sp ium, will be to the detriment of the US economy as a whole, even without retaliation. There could, however, be a series of retaliations and counter-retaliations. How much can world tariffs increase if we move from the current cooperative equilibrium to the non-cooperative equilibrium of a trade war? Two simulation studies indicate that tariffs would increase by 30 or 60 percentage points in trade war scenarios (Nicita *et al.*, 2018; Ossa, 2014).

An estimate of the long-term impact of the most dramatic scenario was established with a 60 percentage points increase in tariffs on manufactured goods between the world's major countries (currently below 3 percent on average for the US and the EU) and restrictions on trade in services (Vicard, 2018). The European single market (post-Brexit) in this scenario remains intact and customs duties remain zero within the EU. Two scenarios are then consid-

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would be the only losers in a trade war. A remarkable result of these simulations is that the losses of the three major trading powers (the United States, China and the EU) are roughly equivalent, namely around 3 percent for China and the United States and 4 percent for the EU. For other open countries, these losses are much higher (more than 10 percent for Ireland, Canada, Switzerland, Mexico and Korea). Moreover, the literature has documented the long-term negative dynamic effects of an increase in customs barriers on long-term growth, in particular through the emergence of an administered economy that is not conducive to innovation and to the proper allocation of production factors[6]. Models integrating this decrease in productivity growth deriving from protectionism result in much higher permanent losses (at least doubled) (Sampson, 2016).

Finding 4. A global trade war would have a permanent effect on the three major global powers (EU, United States and China), of similar magnitude to that of the Great Recession of 2008-09.

These estimates underestimate short- to medium-term effects since the macroeconomic and financial impact is not taken into account on this time scale. In the short- to medium-term, the sharp loss of purchasing power brought about by the increase in taxes worldwide should trigger a negative demand shock and a negative supply shock as well, because of the rise in the price of intermediate goods in global production chains. In addition, the fall in world trade would cause a major sectoral adjustment with large-scale job losses in exporting sectors that would not be able to be quickly offset by job creation in importing sectors, with a resulting sharp increase in unemployment. Several other mechanisms could have a negative impact: higher risk premiums in financial markets, increased uncertainty and possible tightening of monetary policy by central banks in response to inflationary pressures generated by tariffs[7]. The counter argument, however, is that the announcement of Brexit, which actually opened an era of uncertainty for the UK, did not, despite the recent slowdown in UK growth relative to its European partners, trigger the recession that some economists may have feared. Does this mean that the risks of a trade war, with uncertainties that go with them, are overestimated? We do not think so as, in the particular case of Brexit, the United Kingdom was able to benefit, at least in the short term, from a sharp depreciation of its currency, which dampened the shock. Since, in the event of a trade war, the shock would be global, exchange rate adjustments would reflect the relative effects on each country (smaller countries more

(in particular, anti-dumping and anti-subsidy measures). To overcome blockages associated with the consensus rule, plurilateral negotiations, bringing together a critical mass of member countries, are the most credible way forward. E-business, moreover, is another issue on which such an approach would be welcome, given the virtual absence of rules in this area.

Recommendation 2. At the European level, offer plurilateral negotiations to change the WTO's functioning and rules: operation of the DSB, reciprocity conditions given the differences in the level of development and rules relating to subsidies, state-owned companies and intellectual property rights.

In the event of persistent refusal or blocking by the current US administration of the negotiating offers put forward by the EU, which seems to be the most likely scenario currently, the EU should adopt an alternative short-term damage limitation strategy. The EU and its partners then need to identify and analyse all possible strategies for circumventing the US WTO blockage, and even to begin implementing them. For example, in order to circumvent the US blocking of the DSB in the short term, the EU could organise a club of countries excluding the US that would commit to not go to the Appellate Body in the event of appeals filed before the WTO.

Recommendation 3. If it is not possible to break the US blockage of the WTO, organise a club of countries to identify and implement a bypass strategies.

Following the failure of the Doha Round negotiations in July 2006, the major trading powers began to consider a shift in their trade policies towards bilateralism or regionalism. This was in particular the case for the European Commission which, while reasserting its commitment to the multilateral system, has considered it necessary to relaunch negotiations on new generation free trade agreements (FTAs)[10] with its main trading partners. This was done e economic impact of recent or future agreements can be estimated by analysing the e ects of past trade agreements. is analysis is based on the same methodology used to estimate a trade war. e estimated bene ts for the EU of an agreement with Japan would thus be 0.07 percent of GDP, assuming that this agreement corresponds to the 'average' of past agreements (Table 1 on the next page). is method is also applied to Switzerland and the United Kingdom (see the Annex), comparing the current situation with the theoretical case of these countries no longer having a preferential trade link with the EU. For the main possible agreements, the economic bene t for France is between 0.03 percent and 0.23 percent of GDP (between €10 and €79), ie of the same order of magnitude as for the EU as a whole. While these bene ts may appear small, they are not very di erent from the bene ts estimated by the OECD of other structural reforms in France (OECD, 2014). e size of the bene ts varies from one EU country to another primarily in proportion to the intensity of their trade relations with the partner concerned, hence the higher gures for Ireland with the United States. e countries with the greatest bene ts in proportion to their size are those that are relatively small and geographically close. Switzerland is the most extreme case. Its bene ts from a trade agreement are thirty times greater than that of its partner (the EU). e large size of the EU therefore creates a signi cant asymmetry: even if in absolute terms the economic bene ts to be expected from an agreement are often close between the EU and its partner[11], they are much higher as a proportion of GDP for the outside country than for the EU. e small country bene ts strongly from access to a large market while the advantage of access to a small market is small for the EU[12]. e use of this bargaining power in past EU agreements is not obvious as regards tari s, where the practice has been to dismantle them symmetrically, with the exception of a few sensitive agricultural products. Its use is clear, however, in the regulatory eld within which the EU imposes its framework to a large extent in trade negotiations. For example, European Union trade agreements systematically include detailed articles on public procurement and geographical indications. Recent agreements (with the exception of that with Japan) also include the International Court System for Settlement of Investment Disputes.

e current context of protectionist tensions and threats to multilateralism is bringing about a profound change in the scope of trade agreements. While the multiplication of such agreements is likely to be at the expense of multilateralism, they may also represent, for the European Union, an insurance policy in the event of a full-scale trade war with the disappearance of the WTO. Such a trade war scenario in which tari increases do not apply to partners[13] with which the EU has existing or ongoing trade agreements, has been tested. is insurance policy strategy is e ective as it reduces trade war losses for the EU and its member states by one third (Figure 1). Similar results have been observed in recent empirical studies that show that trade agreements, by reducing uncertainty over future demand, act like an insurance policy for exporting companies. During the 2008-09 recession, exports thus fell less among countries that had signed a trade agreement (Carballo , 2015). In addition, preferential agreements signed by the EU have a negative impact on countries that are not included in the trade agreement: this is the case of the United States, which is harmed by the EU-Canada trade deal. ese side e ects of trade agreements are not what motivates countries to sign them but could also be interpreted as retaliatory measures against those who attack multilateralism.

11 In the case of the EU/Switzerland agreement, the bene t is around €19 billion for Switzerland and €17 billion for the European Union.

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Recommendation 4. The European Union should continue to negotiate trade agreements both for the conventional economic benefits they provide and also for the insurance policy role they can play in the event of a full-scale trade war.

However, these agreements need to be part of a new approach consistent with the EU's non-trade objectives such as environmental protection or tax cooperation.

lever can facilitate cooperation in these areas, and the more intense the trade the more e ec-tive the cooperation.

e steps taken to combat climate change provide a striking illustration of this: while the perfect example of the greenhouse e ect externality makes international cooperation essential, this area o ers little incentive for reluctant peenhouse e 4 (e el r)15.1 (eluctan)7 (t p).n the gret exa a bilateral climate agreement between the EU and Canada. Indeed, since the agreements include clauses related to investment, taxation or the environment, the member states must be associated with their adoption[14], as the EU strictly speaking loses its exclusive competence associated with trade.

Recommendation 5. Adjust trade agreements to ensure that trade goes beyond purely economic issues. Prefer an approach of minima and guarantees and combine cooperation and enforceable commitments through safeguard clauses or other explicit mechanisms.

Tax instruments other than customs duties may have an impact on trade terms. This may be the case for corporation tax, which is ultimately borne in part by consumers and workers in open economies[15]. A tax advantage that would specifically benefit an exporting sector can be considered as an export subsidy whose trade distorting effects can be compared to those of customs duties. To be sure, the WTO has a binding instrument regarding direct taxation with the agreement on subsidies and compensatory measures, which makes it possible to impose trade sanctions on countries that use taxation to give their companies a competitive advantage[16]. However, as this rule only applies to the strict area of trade and cannot be applied with regard to tax incentives for investment, the WTO rules need to be changed to better take into account the issue of subsidies.

In the tax area, however, states oscillate between defending their sovereignty and acting within a multilateral or regional framework to avoid the erosion of their tax bases and to protect themselves against unfair competition practices[17]. This is a primary difficulty for the European Union, where tax optimisation issues arise within the EU itself, with countries (often small ones) that are also the main beneficiaries of trade agreements and of the European integration itself. Moreover, due to the short distance, the initial regulatory situation and the presence of a trade agreement, the more trade is integrated between two markets the closer the link between trade and taxation. Companies are indeed more mobile in a more integrated area, ie it is easier to relocate in one market for tax attractiveness reasons and then re-export to another. This aspect must therefore be included in trade agreements with close partners, such as the United Kingdom (Annex). While there is now a standard article in the 'financial services' section of EU Union trade agreements that stipulates (steps taken to combat tax evasion, etc), it does not imply any binding legal commitment (as they are only 'best efforts' commitments) and is not present in all agreements. While it seems difficult to be very specific in the tax provisions associated with a trade agreement, compliance with the OECD codes of good practice and the BEPS (Base Erosion and Profit Shifting) action plan within a multilateral framework ought to be included as an integral part of future agreements[18].

14 As stipulated by the EU Court of Justice in its statement (2/15) of 16 May 2017 on the E Lang (en-hf fut)tip2Tc stipustice-19 (10 (y 2017

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ical position and initial situation (as a member of the EU) are such that an agreement should